

State of Idaho Endowment Funds
Administered by the Endowment Fund
Investment Board

Financial Information and Independent
Auditors' Reports for the Years Ended
June 30, 2003 and 2002

STATE OF IDAHO ENDOWMENT FUNDS
Administered by the Endowment Fund Investment Board

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INDEPENDENT AUDITORS' REPORT

Investment Board
State of Idaho Endowment Funds
Administered by the Endowment
Fund Investment Board
Boise, Idaho:

We have audited the accompanying general purpose financial statements of the State of Idaho Endowment Funds administered by the Endowment Fund Investment Board (the "Investment Board"), a component unit of the State of Idaho, as of June 30, 2003 and 2002, and for the years then ended, listed in the foregoing table of contents. These financial statements are the responsibility of the management of the Investment Board. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the general purpose financial statements present fairly, in all material respects, the financial position of the State of Idaho Endowment Funds administered by the Endowment Fund Investment Board, as of June 30, 2003 and 2002, and the results of their operations for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying financial information listed as supplemental schedules in the foregoing table of contents is presented for the purpose of additional analysis and is not a required part of the general purpose financial statements of the Investment Board. These schedules are the responsibility of the management of the Investment Board. The schedules on pages 23 through 25 have been subjected to the auditing procedures applied in our audits of the general purpose financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the general purpose financial statements taken as a whole. The schedule on page 26 has not been subjected to the auditing procedures applied in our audits of the general purpose financial statements and, accordingly, we express no opinion on it.

The Management's Discussion and Analysis listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Investment Board's management. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in Note 3 to the Endowment Board has restated the financial statements for the year ended June 30, 2002 to correct the allocation of the decrease in fair value of investments between the permanent funds and the earnings reserve funds from a monthly basis to an annual basis as required by statute.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 8, 2003, on our consideration of the Investment Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Deloitte & Touche LLP

August 8, 2003

**STATE OF IDAHO ENDOWMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR-END JUNE 30, 2003**

The discussion and analysis of the State of Idaho Endowment Fund's (the "Fund") financial performance provides a summary of the financial activities of the manager of the Fund, the Endowment Fund Investment Board (the "Investment Board"), for the year ended June 30, 2003. This summary includes a financial summary, an overview of the Fund and the management of the Fund, and the detailed status of the Fund by its components.

FINANCIAL HIGHLIGHTS

Total Fund (Public School & Pooled Combined):

- Fund assets decreased \$15.3 million, which represents a 2.2% decrease from 2002
- Contributions accounted for \$47.7 million, or 7.1% of the Fund
- Distributions to all beneficiaries decreased 18.2% in fiscal year 2003 to \$56,981,500 from \$69,640,000

Public School Fund:

- The Public School Fund investments decreased from \$466,024,059 in fiscal year 2002 to \$446,968,365 for fiscal year 2003
- Total expenses for the Public School Fund were \$11,948,402

Pooled Fund:

- Pooled Fund investments decreased from \$218,493,810 to \$210,016,764 from fiscal year 2002 to 2003
- Total expenses for the fiscal year totaled \$5,649,262

PURPOSE OF THE STATE OF IDAHO ENDOWMENT FUND

The purpose of the State of Idaho Endowment Funds is to manage and invest the revenues generated from the management and/or sale of endowment lands of the state. The total endowment fund consists of two portions: the Public Schools and Pooled Funds.

Monies that are generated from lands endowed to the Public Schools, and thus considered Public Schools Land, are invested for the benefit of Public Schools. This portion of the total fund accounts for approximately two-thirds of the total endowment funds.

The Pooled Fund is an aggregate of monies generated from lands endowed to, and for the benefit of, seven different funds: University of Idaho Agricultural College, Charitable Institutions (Idaho State University, Industrial Training School, State Hospital North, Soldiers' Home, School for Deaf and Blind), Normal School (Idaho State University, Lewis-Clark State College), Penitentiary, University of Idaho School of Science, State Hospital South, and University of Idaho. The assets of these institutions are pooled together for investment purposes, and distributions are based on their proportionate share of the total Pooled Funds.

ROLE OF THE ENDOWMENT FUND INVESTMENT BOARD

The Endowment Fund Investment Board was created by the 1969 Idaho Legislature and charged with management responsibility of the permanent endowment funds of the state. In addition to managing the State of Idaho Endowment Funds, the Investment Board also plays a management role, to differing degrees, for the State Insurance Fund (SIF) investments, Judges Retirement System (JRS) investments, and the Capitol Permanent Endowment Fund investments.

USING THIS ANNUAL REPORT

The annual report consists of the independent auditors' report, the financial statements, the notes to the financial statements, supplemental schedules, examination of management assertions, and the report to management. These statements are organized to give the reader a complete understanding of the total endowment fund, as a whole, along with the specifics of the two individual funds.

FINANCIAL STATEMENTS

The financial statements and notes to the financial statements are prepared by the funds' management. They consist of a balance sheet and a statement of changes in net assets with combined totals. The notes to the financial statements are an integral part of the financial statements and provide additional information on the fund and its operations. These financial statements focus on the total endowed assets of the state, identified by their use of funds: Pooled Funds and Public Schools Fund.

The financial statements and accompanying footnotes reflect all of the assets and liabilities of the fund using the accrual basis of accounting. Under accrual accounting, all the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The financial statements report the fund's net assets, the changes in investments, and the changes in cash balances. As you review these financial statements, you may wish to consider the market difficulty over the past year. Supplemental schedules are provided for your review of detailed expenditures, gains and (losses) on fair value of investments, and weighted return analysis of money managers.

Total Endowment Funds:

The total endowment fund is a combination of the Public School and Pooled Funds. Table 1 highlights the total distributions of the total fund, by beneficiary. The distributions are pre-determined, based on two related factors: 1) the last three-year moving average of the market value of the Fund and 2) the spending policy of the Investment Board, which was 8.0% for 2002 and 7.5% for 2003. Once the last three-year moving average market value of the individual Funds are determined, it is multiplied by the spending policy of the Investment Board, to come up with the current fiscal year distributions (by beneficiary).

Table 1
Total Fund Distributions
(in millions)

	2003	2002	Percent Change
Public School	\$ 37,057	\$ 47,675	(22.3)%
School of Science	4,254	4,709	(9.7)%
University of Idaho	3,504	3,645	(3.9)%
Penitentiary	1,358	1,566	(13.3)%
State Hospital South	1,905	2,024	(5.9)%
Agriculture College	1,139	1,280	(11.0)%
Charitable Institutions	4,070	4,673	(12.9)%
Normal School	<u>3,695</u>	<u>4,068</u>	(9.2)%
Total	<u>\$ 56,982</u>	<u>\$ 69,640</u>	(18.2)

Since the source and use of funds are determined by the distinction of these beneficiaries, our analysis will focus on the financials of the Public School and Pooled Funds separately.

Total Public Schools:

As noted previously, the Public Schools Fund is the portion of the assets managed for the benefit of the Public Schools. Table 2 shows that assets for the Public School Fund decreased 2.3%.

Table 2
Public School Balance Sheet
(in millions)

	2003	2002	Percent Change
Current Assets	<u>\$ 460,976</u>	<u>\$ 472,037</u>	(2.3)%
Liabilities	\$ 21,199	\$ 27,710	(23.5)%
Net Assets—Earnings Reserve	(1,317)	2,778	(147.4)%
Net Assets—Permanent Funds	<u>441,094</u>	<u>441,549</u>	(0.1)%
Total Liabilities and Net Assets	<u>\$ 460,976</u>	<u>\$ 472,037</u>	(2.3)%

Table 3, below, provides a summary of the revenues and expenses of the Public School Fund.

Table 3
Public School Revenues and Expenses
(in millions)

	2003	2002	Percent Change
Land Department Receipts	\$ 35,856	\$ 38,773	(7.5)%
Income from Investments	<u>10,406</u>	<u>13,238</u>	(21.4)%
Total	<u>\$ 46,262</u>	<u>\$ 52,011</u>	(11.1)%
Distribution to Beneficiaries	\$ (37,057)	\$ (47,675)	(22.3)%
Distribution for Expenses—Lands	(9,741)	(8,837)	10.2 %
Distribution for Expenses—Investment Board	<u>(2,207)</u>	<u>(2,780)</u>	(20.6)%
Total	<u>\$ (49,005)</u>	<u>\$ (59,292)</u>	(17.3)%

Revenues reflect all receipts generated by the endowed lands of the Public Schools and the income from investments. During fiscal year 2003, land revenues decreased by 7.5%, due to a reduction in the timber harvests and associated revenue. During the same period, income from investments decreased 21.4%. This decrease represents, in part, the declining interest rate environment of 2003.

Total expenses reflect distributions to beneficiaries as well as expenses paid. The distribution to beneficiaries of \$37,057,000 reflects distributions to Public Schools during the fiscal year, which represented a 22.3% decrease from fiscal year 2002. The distribution for expenses reflects the expenses paid by the EFIB to 1) the Department of Lands for its expenses associated with the management of the lands and 2) the EFIB, for the management of the investments of the Fund.

The decrease in revenues, combined with the increase in expenses account for the decline in the distributions over/under the generated revenue.

Total Pooled Fund:

As noted previously, the Pooled Funds are comprised of seven funds that are pooled together for investment purposes and managed for the benefit of these seven funds. Table 4 shows that assets for the pooled funds decreased 1.9%.

Table 4
Pooled Balance Sheet
(in millions)

	2003	2002	Percent Change
Total Current Assets	<u>\$ 216,749</u>	<u>\$ 220,999</u>	(1.9)%
Liabilities	3,029	1,530	96.7 %
Net Assets—Earnings Reserve	12,949	17,980	(28.0)%
Net Assets—Permanent Fund	<u>200,771</u>	<u>201,489</u>	(0.4)%
Total Liabilities and Net Assets	<u>\$ 216,749</u>	<u>\$ 220,999</u>	(1.9)%

Table 5, below, provides a summary of the revenues and expenses of the Pooled Funds.

Table 5
Pooled Revenues and Expenses
(in millions)

	2003	2002	Percent Change
Land Department Receipts	\$ 15,646	\$ 17,709	(11.6)%
Income from Investments	<u>4,901</u>	<u>6,091</u>	(19.5)%
Total	<u>\$ 20,547</u>	<u>\$ 23,800</u>	(13.7)%
Distribution to Beneficiaries	\$ (19,925)	\$ (21,965)	(9.3)%
Distribution for Expenses—Lands	(4,572)	(4,163)	9.8 %
Distribution for Expenses—Investment Board	<u>(1,077)</u>	<u>(1,312)</u>	(17.9)%
Total	<u>\$ (25,574)</u>	<u>\$ (27,440)</u>	(6.8)%

Revenues reflect all receipts generated by the endowed lands of the Pooled Funds and the income from their investments. During fiscal year 2003 land revenues decreased by 11.6% due to a reduction in timber harvests and associated revenue. During this same period income from investments decreased 19.5%. This decrease represents, in part, the declining interest rate environment of 2003.

Total expenses reflect distributions to the beneficiaries as well as expenses paid. The distribution to beneficiaries of \$19,925,000 reflects distributions to the seven Pooled Funds during the fiscal year, which represents a 9.3% decrease from fiscal year 2002. The distribution for expenses reflects the expenses paid out by the EFIB to: 1) the Department of Lands for their expenses associated with the management of the land and 2) the EFIB for the management of investments of the fund.

FACTORS THAT MAY AFFECT FINANCIAL POSITION

The Endowment Funds are distinct in that both Public School and Pooled Funds have a permanent corpus and an Earnings Reserve Fund. The permanent corpus is to remain intact while the Earnings Reserve Fund is used as an operating account to receive Lands money and interest as well as absorb losses. Distributions to pay beneficiaries and expenses are also paid from the Earnings Reserve Fund.

Under the legislation passed by the 1998 Idaho Legislature, an Earnings Reserve Fund was established to pay all expenses of the Endowment Fund and the Department of Lands and distribution to beneficiaries. Department of Lands receipts and income from interest and dividends are additions to the Earnings Reserve Fund while Lands and Endowment expenses as well as distributions to beneficiaries are depletions. Each June 30, the proportionate share of the gains or losses compared to the Permanent Fund are distributed to the Earnings Reserve Fund.

In the current fiscal year financial statements, there are two funds that are negative in the Earnings Reserve Fund. Agricultural College and Charitable Institutions are both negative due to low Lands receipts and decrease in fair value of their share of the investments. However, those funds are positive when the Permanent Corpus and the Earnings Reserve Fund are considered together.

The investments are heavily market-driven, and even though measures are in place to keep losses down (monitoring equity managers along with fixed income managers reviewing their investments), if a weak stock market continues and losses mount, coupled with the notification by the Department of Lands of a 15% reduction in estimated revenues for the current fiscal year, it is possible the Earnings Reserve Fund will not be able to generate sufficient funds to maintain current distribution levels.

Fixed income markets did well during fiscal year 2003 with equity markets being down due to the economy not bouncing back as unemployment and corporate earnings continued on the weak side. The Public School distribution was short \$6,256,500 while all Pooled Fund distributions were made.

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

BALANCE SHEETS

JUNE 30, 2003 AND 2002

	2003		2002	
	Public School Endowment Fund	Pooled Endowment Fund	Public School Endowment Fund	Pooled Endowment Fund
CURRENT ASSETS				
CASH HELD BY OFFICE OF THE TREASURER	\$ 23,174	\$ 761,048	\$ -	\$ -
INVESTMENTS, AT FAIR VALUE (Note 4)	446,968,365	210,016,764	465,722,680	218,346,432
PURCHASED INTEREST RECEIVABLE (Note 4)			301,379	147,378
RECEIVABLE FOR UNSETTLED TRADES	9,939,920	4,479,446	2,787,313	1,277,172
RECEIVABLE FROM IDAHO DEPARTMENT OF LANDS	2,805,030	1,027,192	774,009	66,985
RECEIVABLE FROM POOLED FUND (Note 10)	262,680			
ACCRUED INTEREST AND DIVIDENDS RECEIVABLE	844,222	399,590	2,300,596	1,090,164
PREPAID TO TREASURER FOR EXPENSES	132,211	64,640	150,842	71,351
	<u>\$ 460,975,602</u>	<u>\$ 216,748,680</u>	<u>\$ 472,036,819</u>	<u>\$ 220,999,482</u>
LIABILITIES AND PRINCIPAL NET ASSETS				
DISTRIBUTION PAYABLE	\$ 15,400,000	\$ -	\$ 23,837,500	\$ -
PAYABLE FOR UNSETTLED TRADES	5,798,798	2,757,334	3,872,371	1,530,270
PAYABLE TO PUBLIC SCHOOL AND CAPITAL PERMANENT FUNDS (Note 10)		271,436		
UNRESTRICTED NET ASSETS—PERMANENT FUNDS (Note 3):				
Public School	441,093,835		441,549,031	
School of Science		42,412,470		42,597,996
Charitable Institutions		42,640,394		42,797,780
University of Idaho		32,574,514		32,729,089
Normal School		37,692,452		37,721,163
Penitentiary		14,437,851		14,506,738
State Hospital South		18,805,892		18,883,763
Agriculture College		12,207,096		12,252,515
Total permanent net assets	441,093,835	200,770,669	441,549,031	201,489,044
UNRESTRICTED NET ASSETS— EARNINGS RESERVE (Note 3):				
Public School	(1,317,031)		2,777,917	
School of Science		2,823,987		5,200,637
Charitable Institutions		(3,181,679)		(1,136,316)
University of Idaho		6,297,258		6,810,647
Normal School		2,732,710		2,603,007
Penitentiary		2,104,962		2,313,610
State Hospital South		3,886,458		2,834,810
Agriculture College		(1,714,455)		(646,227)
Total earnings reserve net assets	<u>(1,317,031)</u>	<u>12,949,241</u>	<u>2,777,917</u>	<u>17,980,168</u>
	<u>\$ 460,975,602</u>	<u>\$ 216,748,680</u>	<u>\$ 472,036,819</u>	<u>\$ 220,999,482</u>

See notes to general purpose financial statements.

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

STATEMENTS OF CHANGES IN NET ASSETS WITH COMBINED TOTAL YEARS ENDED JUNE 30, 2003 AND 2002

	Pooled Endowme			
	School of Science	Charitable Institutions	University of Idaho	Normal School
PERMANENT NET ASSETS, JUNE 30, 2001, as restated (Note 3)	\$ 49,836,259	\$ 49,440,832	\$ 38,709,058	\$ 43,824,229
Receipts from Department of Lands and other public entities	16,000	15,000	15,000	47,000
Decrease in fair value of investments, as restated (Note 3)	(7,254,263)	(6,658,052)	(5,994,969)	(6,150,066)
	(7,238,263)	(6,643,052)	(5,979,969)	(6,103,066)
PERMANENT NET ASSETS, JUNE 30, 2002, as restated	42,597,996	42,797,780	32,729,089	37,721,163
Receipts from Department of Lands and other public entities	18,653	25,860	16,692	149,825
Decrease in fair value of investments	(204,179)	(183,246)	(171,267)	(178,536)
	(185,526)	(157,386)	(154,575)	(28,711)
PERMANENT NET ASSETS, JUNE 30, 2003	<u>\$ 42,412,470</u>	<u>\$ 42,640,394</u>	<u>\$ 32,574,514</u>	<u>\$ 37,692,452</u>
EARNINGS RESERVE NET ASSETS, JUNE 30, 2001, as restated (Note 3)	\$ 6,498,603	\$ 1,855,351	\$ 8,293,987	\$ 4,215,918
Receipts from Department of Lands and other public entities	4,178,920	1,864,206	3,289,610	2,835,129
Change in fair value of investments, as restated (Note 3)	(824,116)	(624,254)	(952,046)	(516,604)
Income from investments (Note 5)	1,327,416	1,207,263	1,090,088	1,121,622
Distributions (Note 6)	(5,980,186)	(5,438,882)	(4,910,992)	(5,053,058)
	(1,297,966)	(2,991,667)	(1,483,340)	(1,612,911)
EARNINGS RESERVE NET ASSETS, JUNE 30, 2002, as restated	5,200,637	(1,136,316)	6,810,647	2,603,007
Receipts from Department of Lands and other public entities	1,647,667	2,677,972	2,331,169	4,131,320
Change in fair value of investments	(12,717)	(11,414)	(10,668)	(11,121)
Income from investments (Note 5)	1,044,205	937,148	875,890	913,065
Distributions (Note 6)	(5,449,263)	(4,890,571)	(4,570,889)	(4,764,891)
Receipt from settlement (Note 10)	62,098	56,194	52,638	56,343
	(2,708,010)	(1,230,671)	(1,321,860)	324,716
EARNINGS RESERVE NET ASSETS, JUNE 30, 2003	<u>\$ 2,492,627</u>	<u>\$ (2,366,987)</u>	<u>\$ 5,488,787</u>	<u>\$ 2,927,723</u>

See notes to general purpose financial statements.

Funds					
Penitentiary	State Hospital South	Agriculture College	Total Pooled Endowment Funds	Public School Endowment Fund	Combined Total
\$ 16,793,792	\$ 22,061,589	\$ 14,114,830	\$ 234,780,589	\$ 511,726,709	\$ 746,507,298
	16,000	1,000	110,000	1,369,674	1,479,674
(2,287,054)	(3,193,826)	(1,863,315)	(33,401,545)	(71,547,352)	(104,948,897)
(2,287,054)	(3,177,826)	(1,862,315)	(33,291,545)	(70,177,678)	(103,469,223)
14,506,738	18,883,763	12,252,515	201,489,044	441,549,031	643,038,075
4,982	19,749	4,110	239,871	2,190,628	2,430,499
(73,869)	(97,620)	(49,529)	(958,246)	(2,645,824)	(3,604,070)
(68,887)	(77,871)	(45,419)	(718,375)	(455,196)	(1,173,571)
<u>\$ 14,437,851</u>	<u>\$ 18,805,892</u>	<u>\$ 12,207,096</u>	<u>\$ 200,770,669</u>	<u>\$ 441,093,835</u>	<u>\$ 641,864,504</u>
\$ 513,336	\$ 3,104,127	\$ 373,766	\$ 24,855,088	\$ 16,202,679	\$ 41,057,767
3,103,910	1,989,040	338,493	17,599,308	37,403,774	55,003,082
181,334	(216,447)	(173,007)	(3,125,140)	(4,774,379)	(7,899,519)
423,656	582,548	338,211	6,090,804	13,237,713	19,328,517
(1,908,626)	(2,624,458)	(1,523,690)	(27,439,892)	(59,291,870)	(86,731,762)
1,800,274	(269,317)	(1,019,993)	(6,874,920)	(13,424,762)	(20,299,682)
2,313,610	2,834,810	(646,227)	17,980,168	2,777,917	20,758,085
1,354,224	3,035,335	228,508	15,406,195	33,665,415	49,071,610
(4,601)	(6,081)	(3,085)	(59,687)	(93,788)	(153,475)
377,777	499,244	253,299	4,900,628	10,405,812	15,306,440
(1,971,456)	(2,605,336)	(1,321,856)	(25,574,262)	(49,004,902)	(74,579,164)
22,808	31,126	14,992	296,199	932,515	1,228,714
(221,248)	954,288	(828,142)	(5,030,927)	(4,094,948)	(9,125,875)
<u>\$ 2,092,362</u>	<u>\$ 3,789,098</u>	<u>\$ (1,474,369)</u>	<u>\$ 12,949,241</u>	<u>\$ (1,317,031)</u>	<u>\$ 11,632,210</u>

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2003 AND 2002

1. GENERAL DESCRIPTION OF THE FUNDS

Accounts Under Jurisdiction of the Endowment Fund Investment Board—The Endowment Fund Investment Board (the “Investment Board”), a component unit of the State of Idaho, is charged with the administration and investment of the Permanent Endowment and Earnings Reserve Funds of the State of Idaho (the “State”), comprised of the Public School Endowment Fund and the Pooled Endowment Funds (College of Agriculture, Charitable Institutions, Normal School, Penitentiary, School of Science, State Hospital South, University of Idaho) held for the benefit of certain State of Idaho institutions. The State of Idaho Endowment Funds (the “Endowment Funds”) are considered part of the State of Idaho financial reporting entity and are included in the State of Idaho Comprehensive Annual Financial Report (CAFR). The Endowment Funds are invested under the variable spending policy established by the Investment Board.

The Idaho Constitution, Article 9, Section 3 prohibits commingling of the Public School Endowment Fund with other funds; consequently, the Public School Endowment Fund does not participate in the earnings of the other seven funds (pooled for investment purposes) which are the Pooled Endowment Funds.

The Endowment Funds are segregated into two Permanent Funds and two Earnings Reserve Funds. The Earnings Reserve Funds consist of the accumulated earnings distributed from the endowment lands or the endowment funds, plus dividends, interest, and realized or unrealized gains on previous earnings reserve balances. All endowment earnings become part of the Earnings Reserve Funds. The administrative expenses of the Investment Board, the Department of Lands, and the management fees for all funds are paid from the earnings reserve funds, based upon legislative appropriation.

The Investment Board has no jurisdiction over assets held by the State Land Board or other agencies; therefore, the Investment Board gives accounting recognition only when a transaction related to Endowment land assets has been consummated by the State Land Board.

The Investment Board employs investment managers for management of the Endowment Funds.

Endowment Funds Investment Reform Legislation—On July 1, 2000, the Investment Board significantly changed operations and reporting of the funds, under new legislation enacted by the Idaho Legislature in 1998.

The new legislation provides that:

- (1) The Investment Board, as trustees, will control, manage and invest Permanent Endowment Funds according to policies established by the State Board of Land Commissioners.
- (2) The application of the Uniform Prudent Investor Act replaces the previous, more restrictive, investment criteria.

- (3) An earnings reserve fund be created to create a buffer to preserve the Permanent Endowment balances.
- (4) Administrative costs be paid from earnings of the Endowment Funds instead of from annual general fund appropriations.
- (5) Distributions to beneficiaries are to be paid from the reserve pool of assets which includes investment earnings, net capital gains and receipts from the Department of Lands.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB is the standard-setting body for governmental accounting and financial reporting principles.

In accordance with GASB Statement No. 20, *“Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,”* the Fund has determined that only Statements of the Financial Accounting Standards Board issued prior to November 30, 1989 are applicable to its financial statements.

Investments—The Investment Board is authorized to invest the Endowment Funds in certain fixed income and equity investments as defined by the policy of the Investment Board and consistent with Section 57-723 of the Idaho Code. This section states in part, “The Investment Board and its investment manager(s) or custodian(s) shall be governed by the Idaho Uniform Prudent Investor act (Chapter 5, Title 68, Idaho Code), and shall invest and manage the assets of the respective trusts in accordance with that act and the Idaho Constitution. In accordance with this code section and the variable spending policy, the endowment funds may be invested in equities (40% to 80% of the investment portfolio with a current target of 70%) and fixed income (20% to 60% of the investment portfolio, with a current target of 30%).” It is the intention of the Investment Board to rebalance the portfolios each November.

The following is a list of allowed investments by asset class:

- (1) Domestic equities
- (2) International equities
- (3) Fixed income securities including U.S. Government agency securities, domestic corporate bonds, notes, debentures, or convertible debt securities with a minimum “BBB” rating by Standard & Poor’s or a “Baa” rating by Moody’s (or equivalent ratings by other national rating services). Yankee bonds with a minimum “A” rating, commercial paper, equity-linked debt with a minimum rating of “A”, passthrough mortgage-backed securities with a minimum “AAA” rating or equivalent, and collateralized mortgage obligations. Investment securities at June 30, 2002 and 2003 are registered in the Investment Board’s name and are in compliance with Investment Board policy and the Idaho Code.

Investment securities are stated at fair value in accordance with GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The fair value of investment securities is based on published market prices and quotations from major investment brokers when available. Purchase and sale transactions are recorded on the trade date.

The Investment Board is also allowed to write derivative instruments, specifically covered call options. The written options typically involve United States treasuries, notes, and bonds with 10 to 30-year maturities, and are usually outstanding for one week to one month. Premiums received from the sale of these options are recorded as a realized gain and increase the principal balance of the investments. If the options are exercised and the bonds are called, the gain or loss is recorded as if the bond had been sold in a normal transaction. No options were outstanding as of June 30, 2003 and 2002.

Income from Investments—Investment income is recognized when earned. Premiums or discounts on short-term investments are amortized and recognized as income from investments. Income from investments is allocated and distributed to each fund participating in the investment pool in the same ratio that each fund's average daily balance bears to the total daily balance of all participants' funds. Income from investments is recorded on an accrual basis. The exception to this is the equity portion of the portfolio where it cannot be determined if an equity position will be held on the dividend expiration date.

Gains and Losses on Sale of Investments—The Investment Board accounts for gains or losses on the sale of investments, in accordance with Section 57-724 of the Idaho Code.

Unrealized gains and losses to Permanent Endowment Funds are determined by comparing the current market value of the Permanent Endowment Funds as of the end of the fiscal year, excluding funds transferred to the Permanent Endowment Funds from the Earnings Reserve Fund or funds deposited as a result of land sales or mineral royalties, to the market value of the Permanent Endowment Fund at the end of the prior fiscal year.

Realized gains or losses on sale or maturity of investments are computed using the difference between actual proceeds received and the costs of investments.

Losses to the Public School Permanent Endowment Fund are made up as follows:

- (1) The State Board of Land Commissioners may annually transfer any funds in the Public School Earnings Reserve Fund that they determine will not be needed for administrative costs or scheduled distributions to the public schools in the following fiscal year to the Public School Permanent Endowment Fund, to make up for any prior losses in value.
- (2) If funds transferred from the Earnings Reserve Fund are insufficient to make up any losses in value to the Public School Permanent Endowment Fund, the remaining loss shall be made up, within four years, by legislative transfer or appropriation. If subsequent gains, as determined pursuant to the provisions of this section, or transfers from the Earnings Reserve Fund, make up for any remaining loss before this four year period expires, then no legislative transfer or appropriation shall be necessary. At June 30, 2003 and 2002 cumulative losses of the Public School Endowment Fund were \$119,359,010 and \$117,474,623.

Losses to Permanent Endowment Funds other than the Public School Permanent Endowment Fund shall be made up from Earnings Reserve Fund monies that the State Board of Land commissioners determines will not be needed for administrative costs of scheduled distributions to each endowments respective fund.

Distributions to Beneficiaries—Distributions are made to public school beneficiaries twice each year. The first distribution is made in mid-February and the second is made in July (for the previous fiscal year). Distributions to the pooled beneficiaries are made in equal installments each month on the 10th (or first business day thereafter). Distributions are based on receipts on the cash basis of accounting.

Reclassification—Certain prior year reclassifications have been made to conform with current year presentation.

Other—Investments have risks that the other parties to securities transactions do not fulfill their contractual obligations. The Investment Board attempts to minimize such risks by diversifying portfolio investments, monitoring investment grade and quality, and purchasing only high-grade or government-backed securities as prescribed by the Idaho Code.

The Investment Board does not intend to use market timing as an investment policy. However, the investment policy provides the flexibility for tactical asset allocation using capitalizations, investment styles, sectors, and other factors.

In accordance with section 57-722 of the Idaho Code, the Investment Board engages in securities lending activities, whereby certain securities (U.S. Government securities and government issues as well as equities) are loaned to specific entities. The securities borrower will pay a stated premium to the Investment Board that is remitted monthly. At the time the securities are loaned, cash or other collateral is received by the Investment Board. Securities lending collateral is comprised of certain U.S. Government issued or U.S. Government agency securities, and is received valued at a required margin of 102% of the market value of the securities loaned. The securities lending agreement requires daily monitoring of the market value of the securities loaned and collateral received with additional collateral obtained as necessary to meet margin requirements.

The Investment Board is indemnified for fraudulent or negligent acts performed by KeyTrust Company National Association dba Victory Capital Management (the "Trustees"), and should loaned securities not be returned as specified, the Trustees would be required to make the Investment Board whole. As such, credit risk exposure is limited under these transactions. As of June 30, 2003 and 2002, the market value of the loaned securities are as follows:

	2003	2002
Public school	\$92,188,576	\$164,182,548
Pooled	\$47,954,715	\$ 82,857,991

3. RESTATEMENT OF DECREASE IN FAIR VALUE OF INVESTMENTS ALLOCATIONS

For the years ended June 30, 2001 and 2002, the allocations of the decrease in fair value of investments were determined on a monthly basis instead of on an annual basis as required by statute. The monthly allocations resulted in a higher proportion of the decreases being allocated to the permanent funds. The corrections are as follows:

PUBLIC SCHOOL ENDOWMENT	Net Assets As Previously Reported	Restatement	As Restated
Permanent Fund:			
Net assets—June 30, 2001	\$ 515,682,228	\$ (3,955,519)	\$ 511,726,709
Decrease in Fair Value of investments—2002	(72,911,966)	1,364,614	(71,547,352)
Net assets—June 30, 2002	444,139,936	(2,590,905)	441,549,031
Earnings Reserve Fund:			
Net Assets—June 30, 2001	12,247,160	3,955,519	16,202,679
Decrease in Fair Value of investments—2002	(3,409,765)	(1,364,614)	(4,774,379)
Net Assets—June 30, 2002	187,012	2,590,905	2,777,917
POOLED ENDOWMENT			
Permanent Fund:			
Net Assets—June 30, 2001:			
School of Science	50,492,636	(656,377)	49,836,259
Charitable Institutions	50,092,001	(651,169)	49,440,832
University of Idaho	39,218,882	(509,824)	38,709,058
Normal School	44,401,424	(577,195)	43,824,229
Penitentiary	17,014,978	(221,186)	16,793,792
State Hospital South	22,352,155	(290,566)	22,061,589
Agricultural College	14,300,732	(185,902)	14,114,830
Decrease in Fair Value of investments—2002:			
School of Science	(7,396,098)	141,835	(7,254,263)
Charitable Institutions	(6,839,674)	181,622	(6,658,052)
University of Idaho	(6,089,338)	94,369	(5,994,969)
Normal School	(6,305,931)	155,865	(6,150,066)
Penitentiary	(2,359,911)	72,857	(2,287,054)
State Hospital South	(3,274,818)	80,992	(3,193,826)
Agricultural College	(1,914,084)	50,769	(1,863,315)
Net Assets—June 30, 2002:			
School of Science	43,112,538	(514,542)	42,597,996
Charitable Institutions	43,267,327	(469,547)	42,797,780
University of Idaho	33,144,544	(415,455)	32,729,089
Normal School	38,142,493	(421,330)	37,721,163
Penitentiary	14,655,067	(148,329)	14,506,738
State Hospital South	19,093,337	(209,574)	18,883,763
Agricultural College	12,387,648	(135,133)	12,252,515

(Continued)

POOLED ENDOWMENT (continued)	Net Assets As Previously Reported	Restatement	As Restated
Earnings Reserve Fund:			
Net Assets—June 30, 2001:			
School of Science	\$ 5,683,890	\$ 814,713	\$ 6,498,603
Charitable Institutions	1,639,561	215,790	1,855,351
University of Idaho	7,251,915	1,042,072	8,293,987
Normal School	3,689,237	526,681	4,215,918
Penitentiary	451,318	62,018	513,336
State Hospital South	2,718,000	386,127	3,104,127
Agricultural College	328,948	44,818	373,766
Decrease in Fair Value of investments—2002:			
School of Science	(389,968)	(434,148)	(824,116)
Charitable Institutions	(972,076)	347,822	(624,254)
University of Idaho	(82,026)	(870,020)	(952,046)
Normal School	(494,827)	(21,777)	(516,604)
Penitentiary	(43,413)	224,747	181,334
State Hospital South	(110,308)	(106,139)	(216,447)
Agricultural College	(254,213)	81,206	(173,007)
Net Assets—June 30, 2002:			
School of Science	4,820,072	380,565	5,200,637
Charitable Institutions	(1,699,928)	563,612	(1,136,316)
University of Idaho	6,638,595	172,052	6,810,647
Normal School	2,098,103	504,904	2,603,007
Penitentiary	2,026,845	286,765	2,313,610
State Hospital South	2,554,822	279,988	2,834,810
Agricultural College	(772,251)	126,024	(646,227)

4. INVESTMENTS

Investments are required by GASB No. 3, *Deposits with Financial Institutions, Investments Including Repurchase Agreements, and Reverse Repurchase Agreements*, to be categorized to give an indication of the level of custodial credit risk as follows: Category 1 (the lowest level of risk) includes insured or registered investments, or investments held by the Endowment Funds or their agent in the Endowment Funds' name; Category 2 includes uninsured and unregistered investments held by the broker or dealer's trust department or agent in the Endowment Funds' name; and Category 3 (the highest level of risk) includes uninsured and unregistered investments held by the broker or dealer, or by its trust department or agent, but not in the Endowment Funds' name. At June 30, 2003 and 2002, all Endowment Funds' investments were subject to categorization and in Category 1.

The State Treasurer is the custodian of the investments of the Public School Endowment Fund which are held under a safekeeping agreement with the Trust Department of KeyTrust Company N.A. and the Northern Trust Company. Investments at June 30, 2003 and 2002 are as follows:

	Public School Endowment Fund			
	2003		2002	
	Cost	Fair Value (1)	Cost	Fair Value (1)
Fund Investments:				
Marketable securities:				
U.S. Treasury bonds and notes	\$ -	\$ -	\$ 41,691,320	\$ 42,256,398
Corporate debentures			73,730,988	76,156,545
Long-term government agencies			20,638,468	21,056,605
Commercial paper			22,590,000	22,590,000
Northern fixed income	132,759,417	131,968,035		
Money market funds	10,579,525	10,579,525	8,706,565	8,706,565
Equity:				
Large cap growth:				
Mastrapasqua	45,459,301	35,287,689	52,440,742	31,435,460
Trainer Wortham			40,387,422	32,499,728
	45,459,301	35,287,689	92,828,164	63,935,188
Mid cap growth:				
Artisan Partners	22,944,691	25,865,573		
MFS Institutional			35,339,879	23,086,441
Mid cap value:				
Oppenheimer Capital	13,085,325	15,003,827		
Systematic	10,209,374	11,747,107		
Small cap growth:				
Nicholas Applegate	12,863,882	15,378,074	15,352,739	15,233,639
Large cap value:				
Metropolitan West	27,531,110	26,029,999	89,424,190	77,000,420
Small cap value:				
Strong Capital	14,909,453	18,762,371	36,786,270	44,336,792
International:				
Marvin/Palmer	27,320,664	29,066,967		
Lazard Asset Management	33,935,005	32,471,397	39,306,833	35,548,666
S&P 500 Index			47,701,240	35,815,421
Northern Trust Equity	95,942,187	94,807,801		
	304,200,992	304,420,805	356,739,315	294,956,567
	447,539,934	446,968,365	524,096,656	465,722,680
Purchased accrued interest			301,379	301,379
Total fund investments	\$ 447,539,934	\$ 446,968,365	\$ 524,398,035	\$ 466,024,059

- (1) Fair values of marketable securities are determined by quotations as of the last business day of June.
Fair values of other investments approximate cost.

The Pooled Endowment Funds' investments are held under a safekeeping agreement with the Trust Department of KeyTrust Company N.A. and the Northern Trust Company. Investments at June 30, 2003 and 2002 are as follows:

	Pooled Endowment Funds			
	2003		2002	
	Cost	Fair Value (1)	Cost	Fair Value (1)
Fund Investments:				
Marketable securities:				
U.S. Treasury bonds and notes	\$ -	\$ -	\$ 19,404,036	\$ 19,731,238
Corporate debentures			34,705,539	35,866,155
Long-term government agencies			9,554,360	9,735,796
Commercial paper			7,200,000	7,200,000
Northern fixed income	61,480,307	61,113,821		
Money market funds	4,642,137	4,642,137	6,854,010	6,854,010
Equity:				
Large cap growth:				
Mastrapasqua	21,564,452	16,527,048	23,979,332	14,795,105
Trainer Wortham			18,906,201	15,279,672
	21,564,452	16,527,048	42,885,533	30,074,777
Mid cap growth:				
Artisan Partners	10,823,823	12,147,233		
MFS Institutional			16,799,966	10,961,271
Mid cap value:				
Oppenheimer Capital	6,179,700	7,077,204		
Systematic	4,812,953	5,536,722		
Small cap growth:				
Nicholas Applegate	6,049,372	7,245,256	7,259,829	7,185,234
Large cap value:				
Metropolitan West	13,036,439	12,250,587	42,235,067	36,320,645
Small cap value:				
Strong Capital	7,067,323	8,848,756	17,281,460	20,833,461
International:				
Marvin/Palmer	13,639,933	14,530,548		
Lazard Asset Management	16,281,043	15,557,853	18,456,472	16,689,708
S&P 500 Index			22,616,455	16,894,137
Northern Trust Equity	44,899,164	44,539,599		
	144,354,202	144,260,806	167,534,782	138,959,233
	210,476,646	210,016,764	245,252,727	218,346,432
Purchased accrued interest			147,378	147,378
Total fund investments	<u>\$ 210,476,646</u>	<u>\$ 210,016,764</u>	<u>\$ 245,400,105</u>	<u>\$ 218,493,810</u>

(1) Fair values of marketable securities are determined by quotations as of the last business day of June. Fair values of other investments approximate cost.

5. INVESTMENT INCOME

Investment income is recognized when earned. Premiums or discounts on short-term investments are amortized and recognized as income from investments. All income from investments is distributed to the Earnings Reserve Funds in accordance with Sections 57-723A and 57-724A of the Idaho Code. Income from investments is allocated and distributed to each fund participating in the investment pool in the same ratio that each fund's average daily balance bears to the total daily balance of all participants funds. Income from investments is recorded on an accrual basis. The exception to this is the equity portion of the portfolio where it cannot be determined if an equity position will be held on the dividend expiration date.

	2003		
	Public School Endowment Fund	Pooled Endowment Funds	Combined Total
INCOME FROM INVESTMENTS:			
U.S. Government and agency securities	\$ 3,237,009	\$ 1,498,276	\$ 4,735,285
Corporate debentures	2,813,279	1,337,099	4,150,378
Short-term investments	329,554	171,979	501,533
Other fixed income	505,555	234,117	739,672
Equity funds	3,187,671	1,517,457	4,705,128
Securities lending	332,744	141,700	474,444
	<u>\$ 10,405,812</u>	<u>\$ 4,900,628</u>	<u>\$ 15,306,440</u>
	2002		
	Public School Endowment Fund	Pooled Endowment Funds	Combined Total
INCOME FROM INVESTMENTS:			
U.S. Government and agency securities	\$ 3,814,464	\$ 1,545,354	\$ 5,359,818
Corporate debentures	5,082,144	2,467,277	7,549,421
Short-term investments	708,509	402,128	1,110,637
Corporate convertible debentures	10,209	6,125	16,334
Equity funds	3,290,473	1,544,036	4,834,509
Securities lending	331,914	125,884	457,798
	<u>\$ 13,237,713</u>	<u>\$ 6,090,804</u>	<u>\$ 19,328,517</u>

6. EXPENSES

Expenses of the Investment Board are paid from the Earnings Reserve Fund and the State Insurance Fund. The State Insurance Fund portion is paid under an investment management contract. Total expenses for fiscal years 2003 and 2002 were as follows: State Insurance Fund—\$135,693 and \$155,415 and Earnings Reserve Funds—\$2,926,683 and \$3,626,469. Investment income and expense at June 30, 2003 and 2002 were as follows:

	2003		
	Public School Endowment Fund	Pooled Endowment Funds	Combined Total
DISTRIBUTIONS:			
To beneficiaries (Note 7)	\$37,056,500	\$19,925,000	\$56,981,500
For expenses—Lands	9,740,780	4,572,320	14,313,100
For expenses—Investment Board	<u>2,207,622</u>	<u>1,076,942</u>	<u>3,284,564</u>
	<u>\$49,004,902</u>	<u>\$25,574,262</u>	<u>\$74,579,164</u>
	2002		
	Public School Endowment Fund	Pooled Endowment Funds	Combined Total
DISTRIBUTIONS:			
To beneficiaries (Note 7)	\$47,675,000	\$21,965,000	\$69,640,000
For expenses—Lands	8,837,038	4,162,962	13,000,000
For expenses—Investment Board	<u>2,779,832</u>	<u>1,311,930</u>	<u>4,091,762</u>
	<u>\$59,291,870</u>	<u>\$27,439,892</u>	<u>\$86,731,762</u>

7. DISTRIBUTIONS TO POOLED ENDOWMENT FUNDS AND SHARING INSTITUTIONS

The Pooled Endowment Fund consists of seven endowment funds (School of Science, University of Idaho, Penitentiary, State Hospital South, College of Agriculture, Charitable Institutions, and Normal School) which received income distributions during the year. Distributions at June 30, 2003 and 2002 were as follows:

	2003	2002
School of Science	\$ 4,254,000	\$ 4,709,000
University of Idaho	3,504,000	3,645,000
Penitentiary	1,358,000	1,566,000
State Hospital South	1,905,000	2,024,000
Agriculture College	1,139,000	1,280,000
Charitable Institutions	4,070,000	4,673,000
Normal School	<u>3,695,000</u>	<u>4,068,000</u>
	<u>\$19,925,000</u>	<u>\$21,965,000</u>

Pursuant to Section 66-1106 of the Idaho Code, Charitable Institutions' Fund income is distributed as follows: Idaho State University, Pocatello—four-fifteenths (4/15), Industrial Training School, St. Anthony—four-fifteenths (4/15), State Hospital North, Orofino—four-fifteenths (4/15), Soldiers' Home, Boise—Five -thirtieths (5/30), and School for the Deaf and Blind, Gooding—one-thirtieth (1/30). Distributions to these sharing institutions at June 30, 2003 and 2002 were as follows:

	2003	2002
Idaho State University, Pocatello	\$1,085,333	\$1,246,133
Industrial Training School, St. Anthony	1,085,333	1,246,133
State Hospital, North Orofino	1,085,333	1,246,133
Soldiers' Home, Boise	678,334	778,834
School for Deaf and Blind, Gooding	<u>135,667</u>	<u>155,767</u>
	<u>\$4,070,000</u>	<u>\$4,673,000</u>

Pursuant to Section 33-3301 of the Idaho Code, Normal School Fund Income is distributed fifty percent (50%) each to Idaho State University Department of Education and Lewis-Clark State College. Distributions to these sharing institutions at June 30, 2003 and 2002 were as follows:

	2003	2002
Idaho State University, Pocatello	\$1,847,500	\$2,034,000
Lewis-Clark State College, Lewiston	<u>1,847,500</u>	<u>2,034,000</u>
	<u>\$3,695,000</u>	<u>\$4,068,000</u>

8. CREDIT ENHANCEMENT PROGRAM FOR SCHOOL DISTRICT BONDS

On July 1, 2002, the credit enhancement program for school district bonds became effective. This program, in accordance with Section 57-782 of the Idaho Code and in conjunction with Chapter 53, Title 33 of the Idaho Code, requires the Public School Endowment Fund to purchase notes of the State of Idaho that are issued to avoid a default in a voter approved bond issued by a school district. This program will result in a higher credit rating for the qualifying school districts and through lower interest costs, will save the school districts in the program thousands of dollars throughout the life of the bond issue.

9. INCOME TAXES

The Endowment Funds are not subject to income tax.

10. RECEIPT FROM SETTLEMENT

In March 2003, a settlement was reached resulting from a class action suit filed for losses suffered in owning certain convertible bonds. The Investment Board received payments based on their holdings of these bonds at the time of filing. As a result of the settlement, the Pooled Fund owes the Public School Fund \$262,680 for that fund's portion of the settlement, and the Pooled Fund owes the Capital Permanent Fund, which is also managed by the Investment Board, \$8,756 for that fund's portion of the settlement.

* * * * *



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Investment Board
State of Idaho Endowment Funds
Administered by the Endowment Fund
Investment Board
Boise, Idaho:

We have audited the general purpose financial statements of the State of Idaho Endowment Funds administered by the Endowment Fund Investment Board (the "Investment Board"), a component unit of the State of Idaho, as of and for the year ended June 30, 2003, and have issued our report thereon dated August 8, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Investment Board's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Investment Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the Investment Board's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Report to Management.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

This report is intended solely for the information and use of the Legislature of the State of Idaho, the Investment Board, the State Land Board, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

August 8, 2003

SUPPLEMENTAL SCHEDULES

STATE OF IDAHO ENDOWMENT FUNDS
Administered by the Endowment Fund Investment Board

SCHEDULE OF EXPENDITURES
YEARS ENDED JUNE 30, 2003 AND 2002

	2003	2002
ADMINISTRATIVE:		
Personnel:		
Salaries	\$ 186,518	\$ 206,604
Fringe benefits	<u>74,422</u>	<u>80,926</u>
Total personnel benefits	260,940	287,530
Operating:		
Consultants	215,679	255,217
Audit fees	57,108	57,415
Equipment rent	23,329	25,255
Travel	19,745	7,929
Office rent	15,749	16,293
Computer software and programming	7,319	27,966
Telephone - data lines	5,355	4,527
Governmental overhead	2,314	1,960
Employee training	2,077	1,112
Dues and subscriptions	797	1,753
Other expenses	<u>7,006</u>	<u>4,608</u>
Total operating expense	<u>356,478</u>	<u>404,035</u>
TOTAL ADMINISTRATIVE EXPENSE	617,418	691,565
INTERNAL FIXED INCOME PORTFOLIO MANAGEMENT	115,112	120,577
OUTSIDE MANAGER BILLINGS:		
Strong Capitol	989,837	1,229,224
Met West	482,554	592,338
Lazard	395,450	411,045
Mastra Pasqua	231,641	306,873
Trainer Wortham	209,162	230,302
Nicholas Applegate	110,054	120,818
MFS	90,018	300,406
S&P	25,869	14,208
Capitol Investors	<u>65,443</u>	<u>65,443</u>
TOTAL OUTSIDE MANAGER BILLINGS	<u>2,534,585</u>	<u>3,270,657</u>
TOTAL OPERATING EXPENSE	3,267,115	4,082,799
CAPITAL:		
Equipment	<u>17,449</u>	<u>8,963</u>
DISTRIBUTIONS TO THE INVESTMENT BOARD	3,284,564	4,091,762
DISTRIBUTIONS TO DEPARTMENT OF LANDS	<u>14,313,100</u>	<u>13,000,000</u>
TOTAL EXPENDITURES	<u>\$ 17,597,664</u>	<u>\$ 17,091,762</u>

(Continued)

STATE OF IDAHO ENDOWMENT FUNDS
Administered by the Endowment Fund Investment Board

SCHEDULE OF EXPENDITURES
YEARS ENDED JUNE 30, 2003 AND 2002

	2003	2002
INTERNAL FIXED INCOME PORTFOLIO MANAGEMENT:		
PERSONNEL:		
Salaries	\$ 74,432	\$ 85,382
OPERATING:		
Travel	662	671
Office rent	10,499	10,862
Dues and subscriptions	476	1,220
Employee training	1,240	774
Telephone - data lines	3,196	3,151
Equipment rent	13,920	7,087
Computer software and programming	4,367	7,936
Governmental overhead	2,138	1,306
Other expenses	<u>4,182</u>	<u>2,188</u>
TOTAL FIXED INCOME PORTFOLIO MANAGEMENT EXPENSES	<u>\$ 115,112</u>	<u>\$ 120,577</u>

STATE OF IDAHO ENDOWMENT FUNDS
Administered by the Endowment Fund Investment Board

SCHEDULE OF GAINS AND (LOSSES) ON FAIR VALUE OF PERMANENT FUNDS'
INVESTMENTS
FOR FISCAL YEARS 2003, 2002 AND 2001

Public School Endowment Fund

FYE	Beginning Corpus	Additions/ Withdrawals to Corpus	Adjust Beginning Corpus	Ending Corpus	Net Gain (Loss)
2000	\$ -	\$ -	\$ -	\$550,216,906	\$ -
2001	\$550,216,906	1,742,339	551,959,245	505,945,949	(46,013,296)
2002	505,945,949	1,369,675	507,315,624	435,854,297	(71,461,327)
2003	435,854,297	1,696,230	437,550,527	435,666,140	(1,884,387)
					<u>\$(119,359,010)</u>

Pooled Endowment Fund

FYE	Beginning Corpus	Additions/ Withdrawals to Corpus	Adjust Beginning Value	Ending Market Value	Net Gain (Loss)
2000	\$ -	\$ -	\$ -	\$253,480,275	\$ -
2001	253,480,275	210,500	253,690,775	231,895,644	(21,795,131)
2002	231,895,644	110,000	232,005,644	199,568,533	(32,437,111)
2003	199,568,533	178,978	199,747,511	199,323,627	(423,884)
					<u>\$ (54,656,126)</u>

STATE OF IDAHO ENDOWMENT FUNDS
Administered by the Endowment Fund Investment Board

WEIGHTED RETURN ANALYSIS BY MONEY MANAGER
YEAR ENDED JUNE 30, 2003 AND 2002

	One-Year	Two-Year Annualized
Pooled:		
Equity	(0.68)%	(9.87)%
Domestic equity	13.10	6.35
Fixed Agg	9.63	8.89
Fixed Pooled	10.16	8.92
Large	12.77	6.19
Mid	N/A	N/A
Small	15.57	7.51
S&P Index	0.14	(9.53)
Met West EFIB	(3.55)	(8.24)
Trainer EFIB	N/A	N/A
Mastrapasqua EFIB	6.57	(17.20)
Oppenheimer	N/A	N/A
Systematic	N/A	N/A
Artisan	N/A	N/A
Strong EFIB	0.39	6.28
Nich-App Fib	(6.84)	(15.05)
Lazard EFIB	(7.25)	(6.13)
Public:		
Equity	(0.68)%	(9.87)%
Domestic equity	13.10	6.35
Fixed Agg	9.63	8.89
Fixed Pooled	8.57	8.85
Large	12.77	6.19
Mid	N/A	N/A
Small	15.57	7.51
S&P Index	0.14	(9.53)
Met West EFIB	(3.21)	(8.08)
Trainer EFIB	N/A	N/A
Mastrapasqua EFIB	5.90	(17.46)
Oppenheimer	N/A	N/A
Systematic	N/A	N/A
Artisan	N/A	N/A
Strong EFIB	0.39	6.28
Nich-App Fib	(6.71)	(14.99)
Lazard EFIB	(7.32)	(6.17)

EXAMINATION OF MANAGEMENT'S ASSERTIONS



INDEPENDENT AUDITORS' REPORT ON EXAMINATION OF MANAGEMENT'S ASSERTIONS

Investment Board
State of Idaho Endowment Funds
Administered by the Endowment
Fund Investment Board
Boise, Idaho:

We have examined management's assertions about the State of Idaho Endowment Funds' (the "Endowment Fund") compliance with certain requirements of the Idaho Code, Chapter 7, Investment of Permanent Endowment Funds, and of the State of Idaho Endowment Fund Variable Spending Policy, during the year ended June 30, 2003, included in the accompanying Statement of Management's Assertions. Management is responsible for the Endowment Fund's compliance with these requirements. Our responsibility is to express an opinion on management's assertions about the Endowment Fund's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining on a test basis, evidence about the Endowment Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination of the Endowment Fund's compliance with specified requirements.

In our opinion, management's assertions that the Endowment Fund complied with the aforementioned requirements for the year ended June 30, 2003, are fairly stated.

This report is intended for the information and use of the Legislature of the State of Idaho, the State Land Board, and the Investment Board and is not intended and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

August 8, 2003

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

STATEMENT OF MANAGEMENT'S ASSERTIONS YEAR ENDED JUNE 30, 2003

Investment securities held at June 30, 2003, were in substantial compliance with Chapter 7, Title 57, of the Idaho Code (the "Code"), and with the State of Idaho Endowment Fund Investment Board Variable Spending Policy (August 2000), Variable Spending Policy (August 2001), Investment Policy, Objectives and Guidelines (August 2001), and the following control procedures were in place for the year ended June 30, 2003 to help ensure compliance with the Code and Policy:

- Investment managers signed confirmation tickets after agreeing them to the Bloomberg system to ensure the transaction was complete and accurate.
- Investments recorded in the general ledger were reconciled to the investment detail recorded in the QED system monthly.
- Investment income and transaction information were agreed to trustee information on a monthly basis.
- Investment transaction detail from the bank was reconciled to the internal transaction detail reports monthly.

The distribution of income from investments and the determination of net capital gains and losses were performed in accordance with Chapter 7, Title 57-724, of the Code.

The Investment Manager weekly advised the Investment Board as to the percentages of the various types of holdings in the fund as required by the Policy, Objective 1, Paragraph 2.

The Investment Board presented a summary report to the legislature of all securities, including investments sold, purchased or acquired by the Endowment Fund since the last report, and the net profit or loss resulting from the sales or purchases of such investments as required by Chapter 7, Title 57-725, of the Code.

The Investment Board has employed Deloitte & Touche LLP, an independent certified public accounting firm, to audit the books and records of the Endowment Fund for the year ended June 30, 2003, required by Chapter 7, Title 57-720, of the Code.

REPORT TO MANAGEMENT



August 8, 2003

Investment Board
State of Idaho Endowment Funds
Administered by the Endowment
Fund Investment Board
Boise, Idaho:

In planning and performing our audit of the general purpose financial statements of the State of Idaho Endowment Funds (the "Funds") for the year ended June 30, 2003, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the Funds' internal control. However, we noted a certain matter involving the Funds' internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the Funds' internal control that, in our judgment, could adversely affect the Funds' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition that we noted is summarized below and is more completely described in Exhibit I.

We noted that there is no consistent review or approval process for manual adjusting entries made to the general ledger. Entries should be scrutinized by someone independent of journal entry preparation.

We also submit our comments concerning certain observations and recommendations relating to other compliance and accounting matters. These recommendations resulted from our observations made in connection with our audit of the Funds' financial statements for the year ended June 30, 2003. Our comments are summarized in Exhibit II.

Comments concerning certain observations and recommendations identified in the prior year, including management's corrective actions, are summarized in Exhibit III.

This report is intended solely for the information and use of Legislature of the State of Idaho, the Investment Board, the State Land Board, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss these comments with you and, if desired, to assist you in implementing any of the suggestions.

Yours truly,

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

Boise, Idaho

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

CURRENT YEAR REPORTABLE CONDITION AND RECOMMENDATION YEAR ENDED JUNE 30, 2003

Observation:

We noted that there is no consistent review or approval process for manual adjusting entries made to the general ledger. Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries, or making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as consolidating adjustments, report combinations, and reclassifications. For this reason, entries should be scrutinized by someone independent of journal entry preparation.

Recommendation:

We recommend that a review and approval process be established for manual adjusting entries.

Agency Response:

Internal procedures will be adjusted, and the Manager of Investments will review and approve all journal entries beginning with those for July 2003.

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

**CURRENT YEAR COMMENTS AND RECOMMENDATIONS
YEAR ENDED JUNE 30, 2003**

Observation:

We observed that Endowment Fund Investment Board (the "Endowment Board") general ledger is reported on a cash basis at year end rather than the accrual basis as required by state statute, and that no entries were recorded in the general ledger to adjust the trial balance to the accrual basis. In particular, no adjustments were recorded in the general ledger to accrue unsettled investment trades, accrued interest receivable, income from securities lending, and distributions to beneficiaries of the Public fund.

Recommendation:

We recommend that the Endowment Board record transactions necessary to adjust the general ledger to the accrual basis. As part of management's review of accrual entries at year end, we recommend developing an efficient system to record and track accrual entries from year to year. As recommended previously, this may be accomplished through the use of an additional period (i.e., period 13) in the accounting system or a manual file to record all accrual entries at year end. Such treatment would allow management analysis of performance on both the cash and accrual basis. In addition, tracking accruals in a separate period would facilitate proper reversal of prior year accrued entries for current year financial statement preparation.

Agency Response:

This was the first year that a period 13 was available, thus no accruals were made until year end. Working with the audit staff, period 13 was used to make accrual entries at year end. Going forward, each month's financial statements will be prepared on an accrual basis, and the internal procedures will be updated accordingly to reflect this change.

Observation:

We observed the process for reconciliation between the Department of Lands (Lands) and STARS did not appear to be functioning on a timely basis, which required additional audit analysis at year end.

Recommendation:

We recommend that management implement monthly reconciliations between Lands and STARS.

Agency Response:

Reconciliations were done on a monthly basis beginning in October of FY 2003. Downloads from STARS were done on a daily basis with a reconciliation done each day with the State Treasurer, who transfers lands money to our custodian bank. In the future, all land department transactions will be reconciled monthly between our general ledger, STARS, and the custodian bank.

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

CURRENT YEAR COMMENTS AND RECOMMENDATIONS (continued) YEAR ENDED JUNE 30, 2003

Observation:

We noted that the Endowment Board personnel recorded purchases and sales on a net basis to the general ledger. Recording these purchases and sales on a net basis requires reconciliation of the investment activity to prove that trustee activity was properly recorded.

Recommendation:

We recommend that the Endowment Board personnel record purchases and sales in separate entries, and track roll forward information on a monthly basis. This will ensure that roll forward information is available for the annual roll forward and will provide a proof of the investments balance.

Agency Response:

This will be implemented beginning in July 2003.

Observation:

We noted that the Endowment Board personnel were accumulating information on unsettled trades from a pending transaction report that did not capture all of the unsettled trades. This causes unsettled trades to be understated in the respective categories of purchases and sales. In addition, it causes roll forward problems as the beginning balance for investments per the trust statements do not match the general ledger in subsequent years.

Recommendation:

We recommend that Investment Board personnel utilize the settled transaction report for at least the first two weeks of the subsequent year in combination with the pending transaction report produced as of the last day of the fiscal year to determine the complete listing of all unsettled trades as of year end. Verification of the completeness of the report should be obtained verbally from the bank.

Agency Response:

This will be implemented, beginning in July 2003 to insure all unsettled trades are properly recorded. Additionally, we will review our custodial relationship to assure we have a custodian who can provide complete, accurate, and timely reports for both our internal use and outside auditor review.

STATE OF IDAHO ENDOWMENT FUNDS
Administered by the Endowment Fund Investment Board

PRIOR YEAR COMMENTS AND RECOMMENDATIONS
YEAR ENDED JUNE 30, 2003

Observation:

We observed that Endowment Fund Investment Board (the "Endowment Board") general ledger is reported on a cash basis rather than the accrual basis as required by state statute, and that no entries were recorded in the general ledger to adjust the trial balance to the accrual basis. In particular, no adjustments were recorded in the general ledger to accrue unsettled investment trades, accrued interest receivable, income from securities lending, and distributions to beneficiaries of the Public fund.

Recommendation:

We recommend that the Endowment Board record transactions on the accrual basis. As part of management's review of accrual entries at year end, we recommend developing an efficient system to record and track accrual entries from year to year. As recommended previously, this may be accomplished through the use of an additional period (i.e., period 13) in the accounting system or a manual file to record all accrual entries at year end. Such treatment would allow management analysis of performance on a cash and accrual basis. In addition, tracking accrual in a separate period may facilitate proper reversal of prior year accrued entries for current year financial statement preparation.

Agency Response:

The 13th period software update has been installed.

Status:

See response above and current year observation.

Observation:

We observed the process for reconciliation of transmissions from the Department of Lands (Lands) did not appear to be functioning on a timely basis from January 2002 to June 2002.

Recommendation:

We recommend that management continue to implement proper reconciliations of Lands receipts.

Agency Response:

Management is implementing a comprehensive reconciliation process for receipt and investment activity.

Status:

Lands receipts are tracked and reconciled daily. Also refer to current year observation.

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

PRIOR YEAR COMMENTS AND RECOMMENDATIONS (continued) YEAR ENDED JUNE 30, 2003

Observation:

We observed that a new document titled Idaho Endowment Board Investment Policy Statement was adopted by the Endowment Board of Directors (the "Board") in the August, 2001 meeting. A new, condensed version of the Variable Spending Policy was also drafted. It is unclear as to which document assumes priority if there are contradictions between the documents. Having more than one policy document covering similar issues may cause confusion among staff and outside fund managers, which may eventually result in non-compliance with the applicable policies and procedures.

Recommendation:

We recommend that management consolidate the desired policies and procedures into one seamless document so that the information is clear and easy to follow for staff and the outside investment managers. Management should also verify that the new document is distributed and understood by the parties to whom it applies.

Agency Response:

A consolidated document is being prepared for approval from the Board.

Status:

The revised Investment Policy Statement is set for review and approval at the August 2003 board meeting. The Variable Spending Policy will be eliminated as part of the revision and consolidation process.

Observation:

We observed that the Board consisted of only eight members after the August 23, 2001 Board Meeting, while the Code requires that the Board consist of nine members. Section 57-719 states that a vacancy shall be filled by the governor for the unexpired term. We noted in the personnel files that on September 10, 2001, the ninth member of the Board, Barbara Wilson resigned from the Board. This vacancy has not been filled. An extended vacancy in this position would be a violation of sections 57-718 & 57-719 of the Idaho Code.

Recommendation:

We recommend that management encourage the necessary procedures to enlist a ninth member to the State of Idaho Endowment Fund Investment Board.

STATE OF IDAHO ENDOWMENT FUNDS

Administered by the Endowment Fund Investment Board

PRIOR YEAR COMMENTS AND RECOMMENDATIONS (continued)

YEAR ENDED JUNE 30, 2003

Agency Response:

Implemented.

Status:

See response above.

Observation:

The Variable Spending Policy (August 2000) states that Yankee bonds are limited to 5% of the market value of the fixed income portion of the total portfolio. We observed that Yankee bonds made up 5.5% of the market value for the Public School fixed income portfolio and 6.6% of the Pooled fixed income portfolio.

Recommendation:

We recommend that investment managers monitor the market value of Yankee bonds within the fixed income portion of the total portfolio to assure compliance with internal investment policies.

Agency Response:

Adjustments have been made to bring holdings into compliance.

Status:

See response above.